

US REGIONAL MANUFACTURING OPTIMISM CONTINUES INTO 2017

**Post-election sentiment remains strong at start of 2017. The Philadelphia Fed manufacturing business conditions indexes for both current and future activity continued to increase in January*

**Jump in unfilled orders measure suggests firms may need to ramp up near-term activity to meet demand*

**Continued optimism suggests firms expect to respond to anticipated fiscal reform and any policy missteps could prove perilous*

The post-election surge in sentiment is proving to be more than ephemeral, with **euphoria continuing into 2017** (see [“US sentiment surges post-election”](#), January 9, 2017). The Philadelphia Fed headline manufacturing index, one of the earliest measures of business sentiment on the month, advanced almost 4 points to 23.6 in January (see Chart 1).

The details on current activity remained strong, with manufacturers reporting high levels of shipments and new orders. The jump in the unfilled orders index by over 7pts to 10.7 - the second highest reading in this economic recovery – was very encouraging for near-term factory activity, especially since manufacturing production levels **remained subdued at the end of 2016** (see [“US Industrial Production Faltered in 2016 but Fiscal Reform Likely to Cause Turnaround in Coming Years”](#), January 18, 2017). The increase in unfilled orders suggest that factories will have to ramp up activity to meet demand.

The six-month ahead section of this report continued to shine bright in January, with the expected business conditions index at 56.6, well above its 2016 average of 33.7 (see Chart 2). Most noteworthy was the six-month ahead employment index, which jumped to its highest level in almost 33 years - a good sign for hiring in the manufacturing industry which shed 45k jobs last year (see Chart 3).

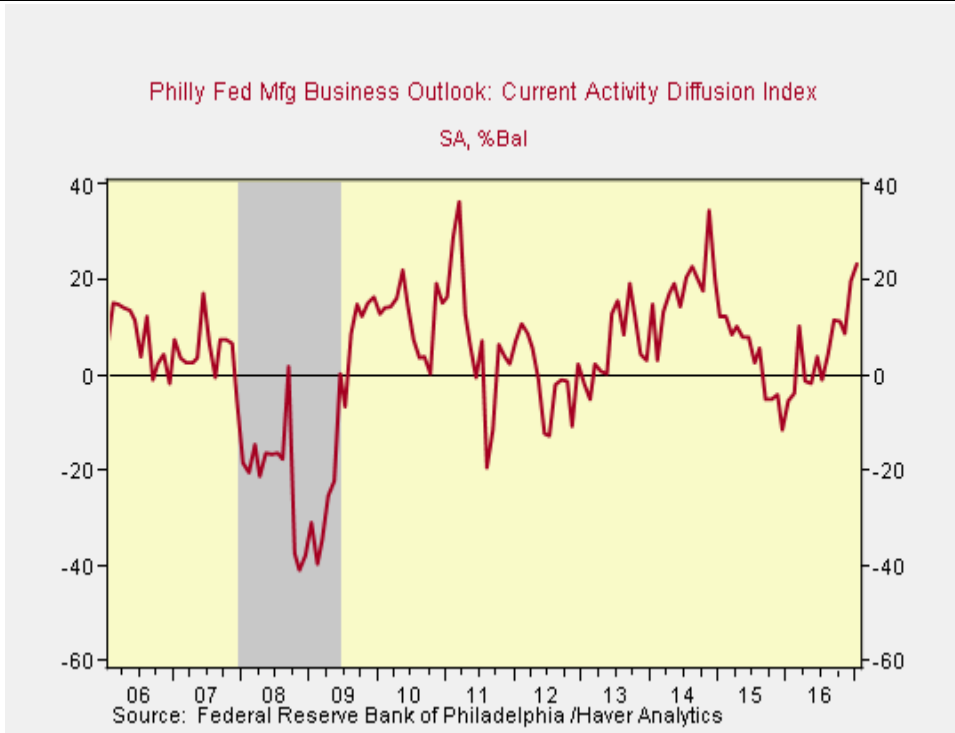
Business pricing expectations have jumped – they expect to pay more for goods and expect to receive more for goods –as businesses probably expect to have greater pricing power if the anticipated fiscal reforms generate an acceleration in economic growth (see Chart 4). The Fed will be watching closely for building price pressures showing signs of overheating the economy as it deliberates on its policy path over the next couple of years.

Expect the pro-business fiscal reform to provide a significant boost to manufacturing as firms should benefit significantly from the lower corporate tax rates, expensing of **new investment and infrastructure spending** (see [“US industries: gainers and losers from policy reform”](#) for an in-depth discussion of impact of economic regime change on US industries).

The continued robustness in the sentiment data suggest that businesses still have high hopes of a new economic policy regime and plan to spur investment in response, anything else could lead to an ugly reversal in US economic activity.

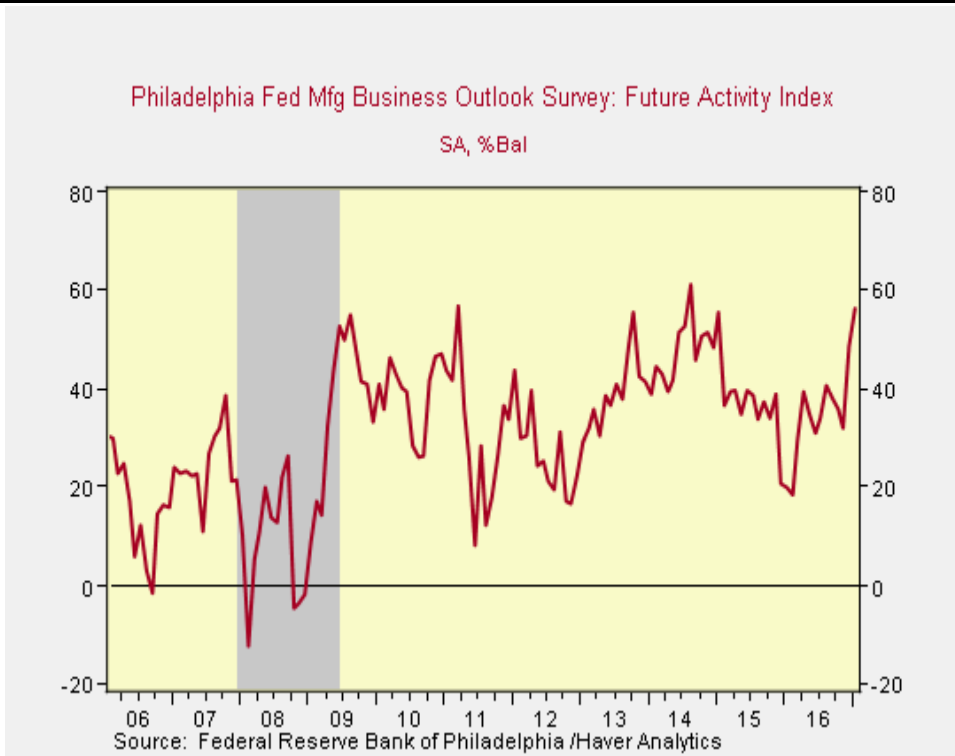
19 January 2017

Chart 1: Philly Fed Manufacturing: Current Activity Diffusion Index



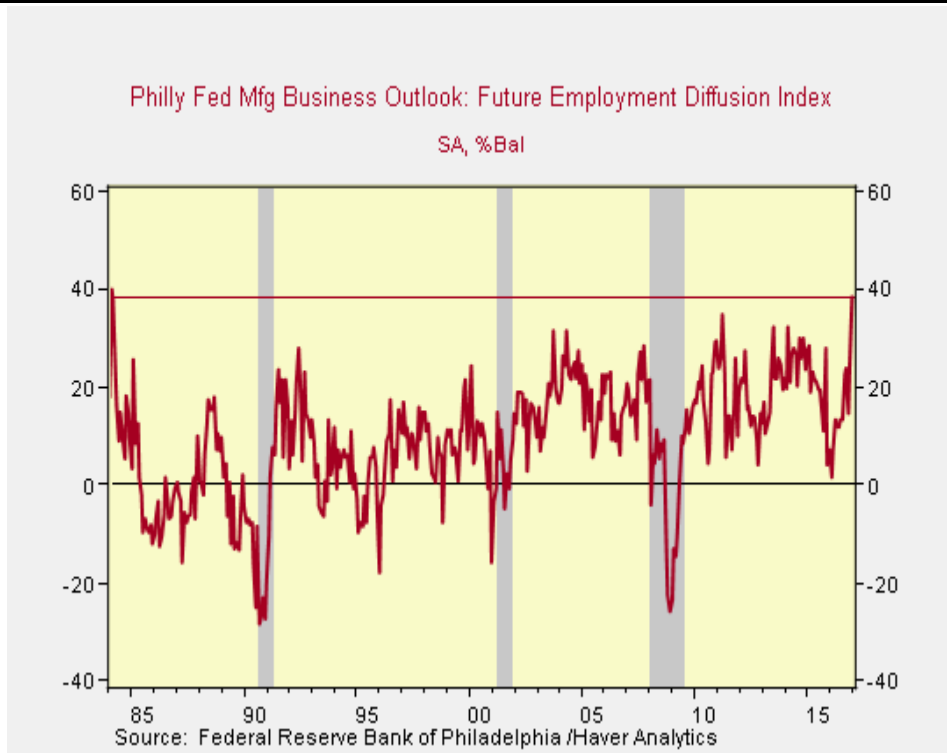
Source: Monthly data. Source: Federal Reserve Bank of Philadelphia and Haver Analytics

Chart 2: Philly Fed Manufacturing: Future Activity Diffusion Index



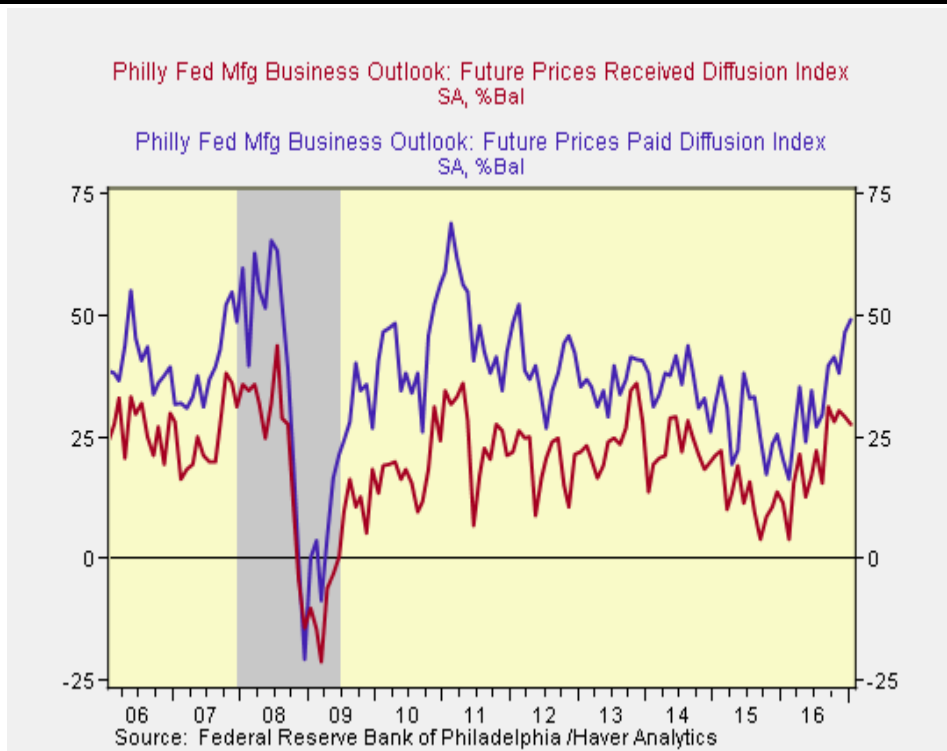
Source: Monthly data. Source: Federal Reserve Bank of Philadelphia and Haver Analytics

Chart 3: Philly Fed Manufacturing: Future Employment Diffusion Index



Source: Monthly data. Source: Federal Reserve Bank of Philadelphia and Haver Analytics

Chart 4: Philly Fed Manufacturing: Future Prices Paid and Received Diffusion Indexes



Source: Monthly data. Source: Federal Reserve Bank of Philadelphia and Haver Analytics

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